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C O N F I D E N T I A L SECTION 01 OF 03 PARIS 000815

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STATE FOR EUR/WE, EB/TRA,

E.O. 12958: DECL: 03/02/2017

TAGS: [EAIR](#) [PREL](#) [FR](#)

SUBJECT: FRANCE: AIRBUS RESTRUCTURES; UNIONS AND
POLITICIANS REACT

Classified By: Charge d'Affairs Thomas J. White for reasons 1.4 (b) and
(d)

11. (SBU) SUMMARY: European aviation giant Airbus presented its "Power 8" restructuring plan February 28, after more than a week of Franco-German wrangling over how job cuts and future production would be distributed between the two countries. The restructuring includes a 10,000 workforce reduction (4,300 in France), the sale of five industrial sites (two in France), and a plan to outsource 50 percent of production, up from 30 percent now. Reaction from French labor groups and politicians was immediate, with workers in several sites stopping work. Socialist candidate Segolene Royal said Airbus required more State investment and management, with UMP candidate Sarkozy saying Airbus' problems stemmed from too much State interference. This debate gives measure to the number of industrial and political issues Airbus will need to confront to make its reform program a success. End summary.

AIRBUS RESTRUCTURES

12. (U) Airbus CEO Louis Gallois presented its highly anticipated "Power-8" cost-cutting program February 28. The announcement, originally scheduled for February 20 and postponed until a Chirac-Merkel summit several days later, resolves Franco-German disagreements over burden-sharing, paves the way for an industrial reorganization designed to cut Airbus' high euro-denominated costs and looks to generate some 2.1 Billion Euros in annual savings by 2010. Pressed by looming financial demands stemming from costly production delays in the super-wide body A-380 and the upcoming launch of the redesigned A-350, Airbus has been looking since December for a formula that could help with financing needs including the estimated 10 Billion Euros needed to get the A-350 off the ground. At best, these cost savings were expected to cover only 30-40% of Airbus' needs for new financing.

13. (U) Power 8 foresees an eventual reduction in Airbus' workforce of some 10,000 jobs: 4300 in France, 3700 in Germany, 1600 in the UK, and 400 in Spain. Of the five industrial sites to be partially or totally sold off, two are located in France, two in Germany, and one in England. It also intends to regroup and streamline production lines. While the A-380 will still be assembled both in Hamburg and Toulouse, future A-350 assembly will be centered in Toulouse, with additional A-320 production slated to come online in Hamburg.

14. (U) In addition, Airbus plans to revise its industrial organization. It will redefine its core business as "overall aircraft and cabin architecture, systems integration, as well as the design, assembly, installation, equipping, customization and testing of major and complex components or manufacturing of core technology parts." Airbus would outsource about 50% of aerostructure work to risk-sharing partners, about double that of earlier programs. Airbus will develop a global partnership network, reducing the number of suppliers and looking to them for investment in downstream activities, including several of the plants slated for sale. A "new industrial organization" based on functional "centers of excellence" focused on each of the participant countries will henceforth manage operations.

REACTION IS SWIFT

15. (U) Labor reaction to the announced cuts was swift, with workers at several sites in France stopping work in protest. Airbus' majority union Worker's Force called a strike for next Tuesday March 6, with other unions expected to join them. The French government defended the cuts, with Prime Minister Dominique de Villepin claiming Thursday that the plan represented "an equitable division" of the costs between France and Germany. He also announced 100 million Euros of new government investment in composite technologies, as well as financial assistance for small companies in the aerospace sector. French government spokesmen have also emphasized that job reductions would come through early retirements and attrition rather than layoffs.

16. (C) German Ambassador Neubert told us that, although the
PARIS 00000815 002 OF 003

planned French layoffs were greater than the German ones (4,000 French vs. 3,600 German), the French work force was larger (22,000 vs. 19,000). That said, France faced more difficulties because of the geographical dispersion of its factories. Germany would consequently have fewer difficulties selling its factories, and German workers would more easily find new jobs. He expressed admiration for Airbus chief Gallois, saying that when he was head of SNCF, he had forced the French to strike a balanced deal with Deutsche Bahn that took into account France's competitive advantage on passenger travel, and Germany's on cargo.

17. (U) The Airbus restructuring plan quickly became an issue in the current presidential campaign. The reaction of the leading candidates, Segolene Royal of the center-left Socialist Party (PS) and Nicolas Sarkozy of the center-right Union for a Popular Movement (UMP) Party, epitomized a traditional left/right split over economic and industrial policy. Royal promised to revisit Airbus' plan if elected, arguing that the financial solution to its problems was for the French state to take the lead in increasing Airbus' capital. The state "will have to contribute, but only on the basis of a solid Franco-German project," she said. Amplifying these comments Thursday evening, Royal also said that "this rightist government" had "scandalously destabilized the company by political appointments" to managing positions. UMP candidate Nicholas Sarkozy took a very different line, saying Airbus' problems stemmed from too much state involvement in its affairs. It is "a shareholders' problem and not a Franco-German problem" he said. "States are not the best industrialists...(Airbus) is suffering from a lack of leadership by an industrial shareholder." As of Thursday evening, EADS shares were off almost 5 percent, although most quoted French companies are similarly down this week.

FUTURE MOVES

8.(SBU) Quite aside from campaign rhetoric, Airbus CEO Louis Gallois' presentation Wednesday also raised anew the possibility of increasing the company's capital, as he admitted that Power 8 would provide only the barest minimum of new financing necessary. Any effort to recapitalize Airbus mother company EADS will revive the fundamental issue of its governance structure, and the delicate balance between French and German public and private shareholders that some observers argue is at the root of the industrial problems Airbus has encountered over the past year. Though reorganization at EADS and Airbus has eliminated some of the redundant Franco-German reporting relationships within the company, the desire of private shareholders Lagardere from France and Daimler-Chrysler from Germany to exit the business has left national governments scrambling to find suitable replacements that would maintain the overall ownership balance between the countries.

¶9. (SBU) New complications are likely. Business daily Les Echos reported Friday morning that eight presidents of Socialist-majority regions in France had written to Prime Minister de Villepin about acquiring a ownership stake in Airbus commensurate with the recent share taken by several German Lander. Midi-Pyrenees President Martin Malvy, in Friday morning's Le Figaro newspaper, called for a "significant" participation of 5-10 percent that would give French regions where Airbus production is located the same "right of supervision and intervention" enjoyed by their German counterparts. At the same time, press accounts have cited Russian Bank VTB (which already owns 5 percent of the company) and the National Investment funds of Qatar and the UAE as possible sources of new funds.

COMMENT:

¶10. (SBU) Power 8 is Airbus' first step toward rationalizing its production and reducing its exposure to Euro-denominated costs that disadvantage it in comparison to Boeing. The industrial challenges will be difficult enough to overcome, as it strives to integrate its operations, secure labor buy-in to necessary job reductions, develop risk-sharing partnerships with suppliers, and transform its organizational culture. If it is not successful, CEO Gallois admits that more changes may be necessary in 12-18 months. Beyond the

PARIS 00000815 003 OF 003

potential labor unrest future job cuts might provoke, the eventual success or failure of "Power 8" will surely have implications for Airbus' future needs for financing, and could play a role in future decisions about how much launch aid to seek from European governments for the A-350, an issue which has been discretely pushed to the future so as not to complicate the U.S./E.U. aircraft subsidy trade dispute currently before the WTO.

¶11. (SBU) Louis Gallois, who is widely admired for the business and political acumen he demonstrated in reforming the French National Railway system, lamented Friday that national conflicts had been "poison" for Airbus. With labor activated, French presidential candidates staking out divergent positions, French and German regions with local jobs at stake now involved, and with other national partners equally determined to preserve jobs and access to new technology, Airbus will probably continue to struggle to balance both the political and financial interests that motivate its shareholders. Moreover, there are indications that new shareholders would most likely be financial rather than industrial partners. It is unclear that outside shareholders such as Russian banks or Gulf investment firms, even if they were to completely replace the French and German companies that wish to exit the business, would necessarily make for a decrease in political interference or an increase in transparency. Unless Airbus gets a windfall reprieve via an improvement in the exchange rate that no one foresees, it

will be grappling with its governance issues for some time to come.

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